COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

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Fitchburg Gas and Electric Light Company	**)**	**D.T.E. 02/24 - 25**
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REPLY BRIEF OF THE MASSACHUSETTS DIVISION OF ENERGY RESOURCES

October 17, 2002

I. INTRODUCTION AND PROCEDURAL HISTORY

On May 17, 2002, the Fitchburg Gas and Electric Light Company, a wholly-owned subsidiary of the Unitil Corporation (the "Company") filed with the Department of Telecommunications and Energy (the "Department"): (1) a petition pursuant to G.L. c. 164, § 94 for approval of a proposed increase of $ 3.4 million dollars in its base rates for firm gas customers, (2) a petition pursuant to G.L. c. 164, § 94 for approval of a proposed increase of $ 3.2 million dollars in its base rates for electric customers (collectively, the "rate petitions"), and (3) a proposed performance-based ratemaking ("PBR") plan for both its natural gas and its electric divisions.

The Department conducted fifteen (15) days of evidentiary hearings between August 5, 2002 and September 10, 2002, and admitted an extensive number of exhibits into evidence.

On September 25, 2002, the Division of Energy Resources ("DOER") and the Attorney General filed initial briefs in the proceeding. On October 9, 2002 the Company filed its initial brief and NSTAR Electric filed a brief purporting to be a reply brief to DOER's initial brief.

On October 9, 2002, the Department issued a memorandum confirming the status of NSTAR's filing as that of a reply brief.[1]

II. STATEMENT OF ISSUES

At the outset, DOER expressly incorporates here its initial brief in this proceeding. Further, DOER states expressly that not including a response to every issue presented does not act as a waiver, in this or any future proceeding.

DOER hereby submits its reply brief, which is limited to the following issues:

A. The validity and weight to be accorded by the Department to the Company's marginal cost studies;

1 The Department memorandum noted that intervenor and limited participant initial briefs were due on September 25, 2002.

B. The position taken by the Company concerning DOER's functional cost allocation recommendations; and

C. The position taken by NSTAR concerning DOER's functional cost allocation recommendations.

III. ARGUMENT

A. The Company's Marginal Cost Studies

The Attorney General questioned the accuracy and reliability of the Company's marginal cost studies in his initial brief (AG Init. Brief at pages 71 – 72) concerning the use of "smoothed data" and the Handy-Whitman Index by the Company's witness, Mr. James Harrison.

DOER acknowledges the Attorney General's concerns, and we recognize that the marginal cost studies may be flawed in some respects. However, DOER maintains that the studies are not so flawed as to prohibit their use for rate design purposes, as proposed by DOER in its initial brief (DOER Init. Brief at pages 15 – 23; Attachments 1 – 10).

DOER recommends the Department use the marginal cost studies as a guide to establishing the Company's future rates. DOER did not and does not recommend the Department equalize class returns or set rates at the Company's estimated full marginal customer and volumetric/energy costs.

The Attorney General also argued that the Company has inflated its overall cost of service and overstated its expenses. DOER concurs with the Attorney General's position that the Department should direct that the Company make any and all appropriate cost adjustments that result in an overall decrease in base rates. In light of a likely decrease [2] following the Department's review, DOER anticipates that the rates it originally proposed to the Department would

2 DOER would also like to point out that a further decrease in distribution rates would occur were the Department to accept DOER's recommendations concerning functional cost allocation, as set forth in its initial brief and at pages 5 – 10 infra.

correspondingly be adjusted downward to be consistent with the Department's final, approved cost of service and revenue requirement for the Company.

B. The Company's Position on Functional Cost Allocation

The Company stated that DOER's recommendation to allocate electric generation and transmission costs to the appropriate function, and to collect these costs via the corresponding billing component, was an issue that was outside of the scope of this proceeding (Company's Init. Brief at pages 167 – 168).[3] The Company based its conclusion on the claim that the Company's current filing is consistent with the sections of the Department's Order in D.T.E. 99-110; Fitchburg Gas and Electric Light Company (Phase II) (2001); that address these costs. This position is without merit and should be rejected by the Department.

D.T.E. 99-110 was a reconciliation proceeding in which the Department disallowed certain costs. The Department did not state that the Company had an absolute right to recover the disallowed costs in base rates. Rather, the Department stated that the Company would have an opportunity to *seek recovery* of the costs in its next rate case. To that extent, the Company is correct; in seeking recovery here, its current filing is consistent with the Department's Order. The error in the Company's position is that it equates *seeking recovery* with *obtaining recovery*. The Company assumes that D.T.E. 99-110 insulates the relevant costs from scrutiny and guarantees the legitimacy of their inclusion in the proposed cost of service.

D.T.E. 99-110 identified the Company's next rate proceeding as the venue for evaluating these costs for propriety for inclusion in base rates. D.T.E. 99-110 did not guarantee recovery

3 The Company did not challenge the merits of DOER's recommendations regarding this issue.

merely by inclusion nor did it direct that the Company's next rate proceeding was a "community chest card reading 'bank error in your favor'…"[4]

The Department should reject the Company's position and address these functional cost allocation issues in this proceeding consistent with the recommendations presented in DOER's initial brief (DOER Init. Brief at pages 5 – 15).

C. NSTAR's Position on Functional Cost Allocation

NSTAR opposes DOER's recommendation that all appropriate generation and transmission costs be accurately allocated to their respective functional billing components (NSTAR Brief at pages 2 – 4). NSTAR advocates for collection of these costs through base rates and urges the Department to refrain from implementing changes in, or refinements to, "well established" cost recovery standards related to the transitional energy services (NSTAR Brief at page 3). NSTAR does, however, acknowledge that the Department could well consider some of the changes recommended by DOER. Anticipating such consideration, NSTAR proffered specific recommendations as to the attributes of costs allocated consistent with DOER's position.

In response to NSTAR's general opposition to DOER's allocation recommendations, DOER avers that NSTAR's position is inconsistent with the current regulatory environment regarding the cost structuring of transitional energy services. Electric restructuring is still a work in progress. All aspects of the process continue to be refined in light of past experience to ensure that the goals of restructuring are achieved. As evidenced by past and ongoing proceedings addressing Default Service ("DS"), there are no "well established" cost recovery principles regarding

4 D.T.E. 99-66-A; Fitchburg Gas and Electric Light Company's Recovery of Costs Related to Gas Inventory; (May 31, 2001) at page 27.

transitional services.[5] In each of these proceedings the Department has recognized the value of reflecting cost causation principles in structuring the cost recovery mechanism for DS. This principle is equally applicable to Standard Offer Service ("SOS").[6]

The Department should reject NSTAR's suggestion that it act in this proceeding in accordance with "well established" cost recovery principles. Rather, the Department should take the opportunity presented by this proceeding and continue to implement restructuring in the most efficient manner. The Department should address the cost allocation/cost recovery issues related to generation and transmission costs consistent with the positions presented in DOER's initial brief.

NSTAR specifically recommends, in the event that the Department considers DOER's cost allocation recommendations, that the Department should only allocate incremental, identifiable and avoidable costs ("I, I, A standard") to the transitional energy service rates. NSTAR defines these costs as having the following three attributes. The costs must be:

(1) the direct result of the distribution company's obligation to provide that service;

(2) incurred in addition to those costs that would otherwise be incurred by the distribution company; and

(3) directly avoided (on a unit basis) when a customer moves to a competitive generation supplier. (NSTAR Brief at pages 3 – 6).

5 It should be noted that NSTAR referenced DOER's acknowledgement of the generic DS proceeding (D.T.E. 02-40) in its initial brief (NSTAR Brief at 2). DOER believes that the generic proceeding has substantial value in terms of modifying DS cost structure. DOER has been, and will continue to be an active participant in such proceedings. However, DOER also believes that company-specific rate proceedings also are an appropriate context to address these issues. Implementation of general policy through specific precedent provides significant value in achieving Department goals, and application within the context of a specific proceeding provides added value in that it creates a real world framework to be applied to future company specific proposals.

6 DOER acknowledges the legal restrictions related to SOS that may limit collection of all related costs contemporaneously with the relevant expenditures. However, the Department's December 1999 Directive provides that the 15% statutory discount is applied across a class, not to the individual customer. This method of application of the discount provides opportunities for the Company to maximize inclusion of all related costs in the pricing of the service.

DOER generally agrees with NSTAR that costs should demonstrate these attributes to be allocated to their respective functions for recovery in the appropriate bill component. However, if a particular cost is exclusive to the generation or transmission function, DOER believes that policy considerations preempt meeting NSTAR's I, I, A standard.

DOER also disagrees with NSTAR's interpretation and application of the I, I, A standard to the particular cost categories discussed in its brief (NSTAR Brief at page 4).

NSTAR states that customer service, billing and supply procurement costs (inclusive of legal and regulatory) do not meet the I, I, A standard (NSTAR Brief at pages 4 – 5). Regarding customer service and billing, this position is based on the fact that a company's customer service and billing department provides these services for all of the unbundled functions. NSTAR argues that these costs are not directly caused by the distribution company's obligation to provide the service (Attribute (1) above) and are not incurred in addition to those costs that would otherwise be incurred by the company (Attribute (2) above). DOER disagrees with this position. The cost of the service is based on the one department serving all the unbundled functions. The size of the associated plant and staff are directly determined by the need to address all three functions, not just the distribution function. If the distribution function was the only function served by the customer service and billing departments, presumably the associated plant and staff would be modified accordingly to be consistent with the company's goal of operational efficiency. Therefore, DOER believes that there are customer service and billing costs that are directly related to a company's obligation to provide the generation and transmission service, and that these costs are incurred in addition to the costs that would otherwise be incurred and are therefore incremental.

Regarding Attribute (3) above; that the costs should be avoidable on a unit basis; the overall cost of the customer service and billing functions would be reduced in proportion to costs associated with providing the relative service/function for the transitional energy services as customers migrated to competitive supply. Thus, these costs would be avoided. Therefore, DOER contends that such costs are avoidable. However, even assuming that the Department determines that these costs are not avoidable, DOER believes that policy considerations require that they be allocated for recovery in the respective bill component and that the Department should therefore require companies to quantify these relative costs and allocate them accordingly.[7]

NSTAR provides, as an example of costs that do not demonstrate Attribute (3); costs must be directly avoided when a customer moves to a competitive supplier; a list of costs associated with supply procurement, including associated legal expenses and regulatory proceeding expenses. NSTAR states that these costs are statutorily required and are therefore unavoidable until the obligation to procure generation services is completely extinguished. NSTAR claims that a ratemaking policy that recovers these costs in generation rates is inappropriate and that cost recovery would be unworkable. NSTAR also claims that the services provide a benefit for all customers and should therefore be recovered in base rates (NSTAR Brief at pages 5 – 6). DOER addresses each of these claims below.

NSTAR claims that transitional service procurement costs and associated legal and regulatory expenses are unavoidable. DOER generally agrees with this position.[8] However, these costs are exclusively related to the provision of the transitional energy services. As stated above,

7 A company may argue that due to the merged nature of a particular function (e.g. customer service and billing), it is difficult to quantify the respective proportional costs associated with the provision of the service for each respective function. While DOER recognizes the efficiency of combining the relevant services in one customer service and billing department, DOER believes that a company can discern and quantify the costs related to each particular unbundled function in relation to the overall cost of the service.

8 DOER notes it is possible that these costs are avoided as customers migrate to competitive supply, not only when all customers migrate to competitive supply. Presumably, the relevant costs may vary with the degree of a company's transitional service obligation. In other words, while transitional service procurement costs are qualitatively unavoidable (until the procurement obligation is completely extinguished), they may be partially avoided on a quantitative basis.

policy considerations should preempt the I, I, A standard and require allocation for recovery through the appropriate bill component.

NSTAR next claims that a ratemaking policy that recovers these costs in generation services is not viable, due to the primarily unchanging costs being recovered from a reduced customer base associated with migration. In response, DOER states that any resulting increase in a transitional service customer's bill would be relatively minimal and should be passed through to the remaining customers. Due to the relatively large transitional service customer base, the glacial pace of migration, and the relatively minimal costs associated with supply procurement, DOER believes that any resulting bill impact to remaining customers would be tolerable, especially in light of the benefits associated with the policy considerations. If the cost per customer is increased as the customer base migrates, this will provide further incentive for remaining customers to migrate and will support the development of the competitive markets by reflecting the true cost of the service, resulting in higher transitional service prices thereby facilitating supplier entry.[9]

NSTAR also claims that transitional energy services benefit all customers, directly or indirectly, and therefore are appropriately collected via distribution rates. DOER believes that NSTAR's description of benefits provided, whether directly or indirectly, is inaccurate. A more appropriate description would be *actual* and *potential* benefits. Existing transitional service customers receive *actual* benefits. Competitive supply customers' *potential* benefits do not vest until such time as they migrate from competitive supply back to transitional service. The point here is that until such time as the benefit vests for competitive supply, customers are in fact receiving no benefits, direct or indirect, from the provision of transitional service. Therefore, customers should

9 NSTAR states that artificially increasing DS or SOS prices is inconsistent with the public interest and has been rejected by the Department (NSTAR Brief at page 4). It should be noted that DOER's recommendation on this point to reflect all DS procurement costs regardless of the customer base size does not result in artificially inflated prices. It merely reflects the true cost of the service.

not be required to subsidize the actual benefit received by the existing transitional service customers.

In addition to the recommendation that all costs meet the I, I, A standard, NSTAR recommends that if unavoidable costs are allocated to their respective function for collection in the appropriate bill component, a cost-reconciliation mechanism would need to be established to ensure timely recovery of any unrecovered costs. NSTAR notes that this would avoid deferrals and the associated carrying costs that increase overall costs to customers.[10] DOER agrees with NSTAR on this issue. NSTAR recommends a yearly accounting and collection through the transition charge or default service adjustment. DOER takes no position with regard to the timing of the reconciliation but notes that a yearly recommendation is reasonable and consistent with the transition charge reconciliation. Regarding the reconciliation mechanism, DOER recommends that any unrecovered costs be reconciled via a default service adjustment. This is most consistent with DOER's policy recommendation regarding aligning cost-causation with cost allocation.

Finally, NSTAR recommends that recovery of costs in generation rates should be implemented in a base rate proceeding. DOER agrees that, ideally, this process should be accomplished in a base rate proceeding. However, DOER does not believe that a base rate proceeding should be the exclusive mechanism to implement the cost allocation recommendations proposed by DOER. DOER believes that it is possible to establish relevant cost proxies that can be applied until such time that a company does file a rate proceeding.

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10 Deferrals raise the issue of intergenerational equity with respect to cost recovery. Although delayed reconciliation

IV. CONCLUSION

For the above stated reasons, DOER requests that the Department consider and act on the comments and recommendations proffered here and through its initial brief.

Respectfully submitted,

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mechanism may result in some degree of inequity, the more timely the reconciliation the less any potential impact.